

November 02, 2007

GLORIA L. FRANKLIN, CLERK

U.S. BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

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CLERK
United States Bankruptcy Court
San Jose, California

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA.

In re:

Case No. 07-52890-ASW

THE BILLING RESOURCE, dba
INTEGRETEL, a California
corporation,

Chapter 11

Debtor.

THE BILLING RESOURCE, dba
INTEGRETEL, a California
corporation,

Adversary No. 07-5156

Plaintiff,

vs.

FEDERAL TRADE COMMISSION, et al.,

Defendants.

MEMORANDUM DECISION RE ORDER TO SHOW CAUSE
REGARDING PRELIMINARY INJUNCTION

Before the Court is an Order to Show Cause ("OSC") why a preliminary injunction should not issue enjoining the Federal Trade Commission ("FTC") and David R. Chase ("Receiver"), not individually, but solely in his capacity as receiver for Access One Communications, Inc. ("Access One") and Network One Services, Inc. ("Network One")¹ from taking actions against The Billing Resource,

¹ In addition to these two entities, Receiver is also the receiver for several other entities in
(continued...)

1 dba Integretel ("Integretel" or "Debtor")² in the action captioned
 2 Federal Trade Commission v. Nationwide Connections, Inc., et al.,
 3 Case No. 06-80180-Civ-Ryskamp ("Florida Action") pending in the
 4 United States District Court for the Southern District of Florida
 5 ("Florida Court"). Debtor seeks to enjoin the FTC from prosecuting
 6 the enforcement aspect of the Florida Action ("Enforcement Action")
 7 against Debtor (and not against the other defendants in that
 8 action) as well as enjoining the Receiver from implementing or
 9 enforcing the Omnibus Order entered in the Florida Action on
 10 September 14, 2007 ("Omnibus Order") (as it relates solely to
 11 Debtor, and not to any other defendants). Debtor also seeks to
 12 unblock \$1,762,762.56 currently held by Debtor in a blocked account
 13 ("Blocked Account"). These funds were taken from Debtor's general
 14 commingled funds and placed temporarily in the Blocked Account
 15 pursuant to a stipulation between Debtor and Receiver -- at the
 16 suggestion of the Court -- entered into at the September 26, 2007
 17 hearing on Debtor's interim motion for use of cash collateral.

18 A hearing on the OSC was held on October 17, 2007 and the
 19 matter has been submitted for decision. Debtor is represented by
 20 Michael H. Ahrens, Esq. and Steven B. Sacks, Esq. of Sheppard,
 21 Mullin, Richter & Hampton, LLP. FTC is represented by Michael P.
 22 Mora, Esq. and Collot Guerard, Esq. Receiver is represented by
 23 Walter K. Oetzell, Esq. of Danning, Gill, Diamond & Kollitz, LLP
 24 and Jeffrey C. Schneider, Esq. of Tew Cardenas LLP. The Official
 25

26 ¹(...continued)
 27 the litigation brought by FTC in which Receiver was appointed. The only two receivership entities
 28 that are relevant to these proceedings are Access One and Network One.

² This Court will use Integretel to differentiate actions taken by or events related to Debtor
 that occurred pre-petition.

Committee of Unsecured Creditors ("Committee") is represented by John D. Fiero, Esq. of Pachulski Stang Ziehl & Jones LLP. Creditor POL, Inc. is represented by Kathryn S. Diemer, Esq. of Diemer, Whitman & Cardosi, LLP. Creditor PaymentOne Corporation ("PaymentOne") is represented by Stephen H. Warren, Esq. of O'Melveny & Myers LLP. Creditor United Online, Inc. is represented by Jeffrey K. Garfinkle, Esq. of Buchalter Nemer. BSG Billing Solutions is represented by James A. Pardo, Jr., Esq. and Felton E. Parrish, Esq. of King & Spalding LLP.

This Memorandum Decision constitutes the Court's findings of fact and conclusions of law, pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

I.

FACTS

A. Debtor's Business³

Debtor provides billing-related and other services for smaller private telecommunications companies that compete with large local exchange carriers ("LECs") in niche areas such as public pay phones, hotels and prisons ("Alternative Operator Services"). Private telecommunications companies that provide Alternative Operator Services have difficulty billing for "collect" and other types of calls, since most individuals do not pay invoices from these unknown companies and those companies cannot bill the individuals through the individual's normal telephone bill. Debtor

³ While "Debtor" refers to the post-petition business entity and "Integretel" refers to the pre-petition business entity, the Court uses Debtor in the following section rather than Integretel because the section describes Debtor's business both pre- and post-petition.

1 was created in 1988 to address this void in the marketplace.
2 Debtor has billing and collection agreements with an estimated
3 1,400 LECs -- both major local exchange companies and numerous
4 independents. Debtor's infrastructure permits private
5 telecommunications providers to incorporate such providers' charges
6 into the phone bills of more than 90% of business and residential
7 consumers throughout the United States and Canada.

8 The typical service contract between Debtor and its service
9 provider customers provides that the customer submits to Debtor the
10 customer's billing transaction in a data format acceptable to
11 Debtor. In the typical service contract, the customers acknowledge
12 that these billing transactions are structured as a purchase of
13 accounts receivable. Debtor contends that its customers have no
14 ownership interest in the proceeds of the billing transaction after
15 the billing transactions are submitted to Debtor and its customers
16 hold only an unsecured claim against the distributions payable by
17 Debtor to the customer under the service contracts -- usually in 90
18 or so days. The service contracts provide detailed formulas for
19 computing the amounts Debtor owes to its customers. Debtor
20 maintains certain reserves for disputes, fees and other adjustments
21 as bookkeeping entries only.

22 The service contracts provide that each week Debtor transfer
23 by wire to its customers' bank accounts the net proceeds identified
24 in the prior week as defined by the service contracts. This amount
25 is forwarded approximately 90 days after the submission of the
26 billing transaction. Once Debtor receives a billing transaction,
27 Debtor submits the billing information to the LECs and the LECs in
28 turn bill the end user. At varying intervals, the LECs make

1 payments into Debtor's "wire in" account based on the billing
2 transactions previously submitted to the LEC. Funds are
3 transferred into this account every day throughout the day.

4 Once a week -- typically on a Thursday -- Debtor settles its
5 accounts with its customers. To settle accounts, Debtor disburses
6 funds from the "wire in" account to the "wire out" account. The
7 "wire out" account is a zero balance account meaning that all funds
8 transferred into that account are generally transferred out to
9 several other accounts on the same day. It is from these other
10 accounts that Debtor: (1) pays its vendors, employees and other
11 operating expenses; (2) collects taxes that Debtor is required to
12 collect in connection with Debtor's business; (3) makes payments to
13 LEC end users that are entitled to a cash voucher for a refund;⁴
14 and (4) holds excess funds, if any, from weekly settlements to
15 cover subsequent operating shortfalls including settlement
16 obligations that exceed available funds in the "wire in" account.

17 Debtor has approximately thirty-seven employees. In 2000,
18 Debtor formed PaymentOne as a subsidiary to address the specialized
19 billing and support requirements of the internet. Debtor owns 97%
20 of PaymentOne. In 2002, Debtor formed another majority-owned
21 subsidiary known as Inmate Calling Solutions, LLC to target the
22 correctional industry and in 2004, Debtor formed yet another
23 majority-owned subsidiary known as Information Services 900 LLC to
24 target 900 call traffic.

25
26 ⁴ Certain individual or business consumers are occasionally entitled to a refund or a credit.
27 This results, inter alia, from an error in billing. Debtor asserts that 95% of these cases are corrected
28 electronically through an automated credit transaction. In the 5% of errors handled through the
issuance of a voucher to the consumer, the voucher -- redeemable for cash -- is drawn from the
voucher account.

1 **B. Florida Action**

2 On February 27, 2006, the FTC commenced the Florida Action in
 3 the Florida Court against three Alternative Operator Services
 4 providers as well as their principals (not Integretel or its
 5 principals) for alleged deceptive and unfair practices for
 6 unauthorized billing of charges on phone bills in violation of the
 7 Federal Trade Commission Act. The FTC alleged that these
 8 defendants had defrauded consumers throughout the United States of
 9 more than \$30 million by placing unauthorized collect call charges
 10 onto consumers' telephone bills. At the request of the FTC, the
 11 Florida Court entered an *ex parte* temporary restraining order
 12 ("TRO") that shut down the defendants' alleged unlawful operation,
 13 froze the defendants' personal and corporate assets and appointed
 14 Receiver as temporary receiver for the corporate defendants. Two
 15 of the corporate defendants -- Access One and Network One -- were
 16 prior customers of Integretel (collectively, "Prior Customers").
 17 On March 8, 2006, a preliminary injunction was entered
 18 ("Preliminary Injunction") and Receiver was permanently appointed.

19 Both the TRO and the Preliminary Injunction provided, inter
 20 alia, that any business entity served with a copy of the TRO or
 21 Preliminary Injunction

22 that holds, controls, or maintains custody of any account
 23 or asset of any Defendant, or has held, controlled or
 24 maintained custody of any such account or asset at any
 time since the date of entry of this Order, shall:

- 25 A. Hold and retain within its control and prohibit
 26 the withdrawal, removal, assignment, transfer,
 27 pledge, encumbrance, disbursement, dissipation,
 conversion, sale, or other disposal of any such
 asset except by further order of the Court;

28 . . .

1 TRO at page 8; Preliminary Injunction at page 9. The FTC asserts
2 that the FTC served Integretel with the TRO within days of the
3 entry of the TRO.

4 On March 6, 2006, Integretel's president, Ken Dawson,
5 submitted a letter to the FTC stating in relevant part that:
6 (a) Integretel had service contracts with the Prior Customers;
7 (b) pursuant to the service contract with the respective Prior
8 Customer, each Prior Customer was entitled to certain proceeds from
9 billing transactions; however (c) each Prior Customer was in
10 default under the service contract and no amounts were currently
11 due and owing. Mr. Dawson noted that Integretel had not processed
12 any billing for Access One since May 2005 nor for Network One since
13 June 2003. With respect to each Prior Customer, Mr. Dawson stated:
14 "[t]o the extent proceeds become due to [Prior Customer] in the
15 future, we will establish a separate bank account into which such
16 funds will be deposited and notify your office accordingly."⁵ Pre-
17 petition Integretel did not establish any such separate bank
18 account.

19 On September 21, 2006, the FTC filed an amended complaint
20 asserting claims against Integretel for Integretel's collection of
21 alleged fraudulent charges. Specifically, the complaint asserts
22 that Integretel deceptively billed consumers for collect calls that
23 were never made, received or authorized. In its complaint, the FTC
24 seeks a monetary judgment as well as multiple forms of non-monetary
25 relief such as a permanent injunction against pertinent law
26

27 ⁵ Letter dated March 6, 2006 from Ken Dawson to Roberto Menjivar, Attachment B to
28 Declaration of Laura Kim in Opposition to Plaintiff's Motion for a Temporary Restraining Order and
Preliminary Injunction filed on October 1, 2007.

1 violations, "fencing-in" injunctive relief, rescission of contracts
2 and a claims procedure for consumer redress. Integretel filed an
3 answer denying the FTC's allegations. Integretel's principals were
4 not named in the amended complaint.

5 On October 16, 2006, Receiver filed a motion in the Florida
6 Court seeking to hold Integretel in contempt of court for
7 Integretel's alleged failure to turn over to the Receiver on behalf
8 of the Prior Customers certain "reserves" under the service
9 contracts with the Prior Customers in an alleged amount in excess
10 of \$1.4 million. Integretel opposed the motion on various grounds,
11 including: (a) Integretel did not hold any such reserves in a
12 separate account; (b) the service contracts in place with the Prior
13 Customers permitted Integretel to withhold certain monies owed to
14 the Prior Customers as "reserves"; and (c) Integretel was not
15 obligated to turn over those funds under the respective service
16 contracts. Integretel also filed its own motions to modify the
17 Florida Court's injunctive orders and to stay the contract claims
18 pending arbitration. A hearing on these motions was held on
19 April 12, 2007.

20 On September 14, 2007, the Florida Court entered the Omnibus
21 Order. In the Omnibus Order, the Florida Court found that
22 Integretel held reserves in the amount of \$1,762,762.56 on behalf
23 of the Prior Customers as of June 30, 2007 ("Commingled Funds").
24 The Florida Court stated that Integretel's assertion that the
25 "reserves" were not held as segregated funds but rather were kept
26 in a pooled account and tracked via an internal accounting entry
27 was "a distinction without a difference, since the TRO captures
28 funds 'held on behalf of, or for the benefit of, a Defendant.'"

1 Omnibus Order at 3. The Florida Court noted that "[a]n entity need
2 not be an agent, partner, joint venturer, trustee, fiduciary, or
3 legal representative to possess funds that one is holding 'on
4 behalf of' another person or entity..." Id. The Florida Court
5 also rejected Integretel's arguments that Integretel could retain
6 the "Commingled Funds" to fund Integretel's assertion of an
7 indemnity claim or liquidated damages for breach of contract
8 against the Prior Customers. Id. at 4.

9 Regarding Integretel's motions, the Florida Court denied
10 Integretel's request to stay the contract claims pending
11 arbitration of those claims pursuant to the service contract
12 arbitration clause, since the Florida Court concluded that Receiver
13 was not bound by the those clauses. The Florida Court stated in
14 particular:

15 The Receiver's claim is not a claim at law governed by
16 pre-receivership contracts, however, but one governed by
17 this Court's jurisdiction over receivership property
18 based on the TRO and Amended Preliminary Injunction. The
19 Receiver does not claim that the funds must be turned
20 over according to, or by adopting, a contract signed
between Integretel and Access One/Network One. The
Receiver is seeking to recover the reserve funds pursuant
to the Court's in rem jurisdiction over receivership
property, as memorialized in the TRO and the Amended
Preliminary Injunction.

21 Omnibus Order at 4. In response to Integretel's argument that the
22 TRO and Preliminary Injunction would be invalid if those orders
23 permitted the Florida Court to determine Integretel's ownership
24 interest -- or lack thereof -- in the Commingled Funds without a
25 new, separate legal proceeding, the Florida Court stated: "[i]ssues
26 concerning entitlement to disputed receivership property, in fact,
27 are the types of issues typically determined via summary
28 proceedings in the federal court equity receivership context."

1 Id. at 5. The Florida Court rejected Integretel's arguments that
 2 Integretel was deprived of due process when the Florida Court
 3 issued the TRO and Preliminary Injunction and also rejected
 4 Integretel's various arguments that those orders are invalid. The
 5 Florida Court also denied Integretel's request to modify those
 6 orders. Finally the Florida Court:

7 ORDERED AND ADJUDGED that the Receiver's Revised
 8 Motion for Order to Show Cause Why Integretel Should Not
 9 Be Held in Contempt of Court, filed October 16, 2006 **[DE**
 10 **246]**, is GRANTED. Integretel shall show cause in writing
 11 within 10 days of the date of this Order why it should
 12 not be held in contempt for failure to turn over the
 13 reserves. In addition, Integretel shall provide a sworn
 14 statement identifying the amount of reserves as of the
 15 issuance of the TRO. The Court further orders that these
 16 funds shall be placed in a segregated Receivership
 17 account. It is further

18 ORDERED AND ADJUDGED that Integretel's Motion to
 19 Modify Prior Injunctive Orders, filed October 30, 2006
 20 **[DE 294]**, is DENIED. It is further

21 ORDERED AND ADJUDGED that Integretel's Motion to
 22 Stay Contract Claims, filed December 29, 2006 **[DE 363]**,
 23 is DENIED. . . .

24 Omnibus Order at 10. On September 16, 2007, promptly after
 25 receiving the Omnibus Order, Integretel filed its bankruptcy
 26 petition.

27 Debtor is one of seventeen defendants in the Florida Action.
 28 Other than two pending motions regarding depositions, discovery is
 complete in the Enforcement Action.⁶ Dispositive motions are
 scheduled to be filed very soon -- by November 6, 2007, with
 opposition to those motions to be filed by December 4, 2007, and
 replies due by December 18, 2007. Debtor asserts that Debtor will

⁶ Integretel filed a motion to continue one deposition and another billing aggregator
 defendant filed a motion requesting ten additional depositions. The FTC opposed both motions and
 the Florida Court had not ruled on those motions as of October 15, 2007.

1 not be filing any dispositive motions, but anticipates having to
2 respond to dispositive motions filed by other parties. The FTC has
3 stated that the FTC will seek summary judgment against Debtor.
4 Debtor asserts that a two- to four-week trial is set to commence in
5 the Florida Action on February 25, 2008. The FTC predicts that the
6 FTC will prevail on the liability aspect in summary judgment and if
7 not, the FTC estimates that the trial will be no more than nine
8 days, and other defendants contend that the trial will take ten to
9 fifteen days at most. The FTC does not contend that a preliminary
10 injunction against Debtor interferes with the FTC from proceeding
11 with the Enforcement Action against any of the other sixteen
12 defendants.

13 Debtor anticipates having to spend \$821,600 in litigation
14 costs over the next six months related to depositions, discovery
15 motions, dispositive motions, other motions, pre-trial submissions
16 and trial.⁷ Debtor does not break out the estimated fees into the
17 various subcategories. Debtor estimates that in addition to those
18 fees there will be an estimated \$10,000 in fees for local counsel
19 and an estimated \$50,000 to \$75,000 in costs.⁸ In addition to
20 these estimated fees and costs, Debtor estimates that Debtor will
21 incur an additional \$50,000 to \$150,000 in fees related to
22 Receiver's request for turnover of the Commingled Funds.⁹
23
24
25

26 ⁷ Declaration of Neal Goldfarb in Support of Emergency Motion for Temporary Restraining
27 Order and Preliminary Injunction filed on September 24, 2007 ("Goldfarb Dec.") at ¶¶ 5-6.

28 ⁸ Goldfarb Dec. at ¶ 7.

⁹ Goldfarb Dec. at ¶ 8.

C. Events since Debtor Filed Its Bankruptcy Petition

As noted above, Debtor filed this chapter 11 bankruptcy case on September 16, 2007. On September 17, 2007, Debtor filed a Notice of Bankruptcy in the Florida Action. On September 18, 2007, this Court generated a Notice of Chapter 11 Bankruptcy Case, Meeting of Creditors, & Deadlines setting, inter alia, a meeting of creditors for October 17, 2007 and a deadline for filing a proof of claim for non-governmental units of January 15, 2008 and for governmental units of March 14, 2008. On September 20, 2007, the Florida Court issued an order stating that the Florida Action was stayed by the automatic stay.

On September 21, 2007, the FTC filed an emergency motion for clarification that the automatic stay did not apply to the Enforcement Action and the contempt proceedings. On the same day, without granting Debtor an opportunity to respond to the FTC's emergency motion either in writing or orally, the Florida Court issued its Order Granting Motion for Clarification as to Scope of Stay ("Clarification Order"). In the Clarification Order, the Florida Court stated that in the Omnibus Order the Florida Court had "ruled that the reserve funds are the property of the receivership estate and ordered Integretel to pay the current reserve funds, amounting to \$1,762,762.56, immediately to the Receiver." Clarification Order at 1.

Furthermore, the Florida Court held that Bankruptcy Code section 362(b)(4)¹⁰ did not stay the Enforcement Action. The

¹⁰ Unless otherwise noted, all statutory references are to Title 11, United States Code, as amended in 2005 ("Bankruptcy Code").

1 Florida Court also stated with respect to the contempt proceedings
2 brought by the Receiver:

3 Nor is the contempt proceeding stayed. First, the
4 automatic stay applies only to protect property of the
5 bankruptcy estate or property of the debtor. See
6 11 U.S.C. § 362(a)(2). The Court has already ruled that
7 the reserve funds are neither the property of the
8 "bankruptcy estate" nor Integretel. Second, the
9 11 U.S.C. § 362(b)(4) exception also applies to civil
10 contempt proceedings brought by a governmental unit in
11 the exercise of its police or regulatory powers. See SEC
12 v. Bilzerian, 131 F. Supp. 2d 10, 14 (D.D.C. 2001) (civil
contempt proceeding falls within the exception;
incarceration of debtor subsequent to failure to provide
financial information as required by purgation provision
in prior disgorgement order). Finally, the bankruptcy
filing does not deprive this Court of its inherent power
to enforce the integrity of its orders. "[C]ontempt
orders to uphold the dignity of the court are excepted
from the automatic stay." NRLB v. Sawulski, 158 B.R.
971, 975 (E.D. Mich. 1993).

13 Clarification Order at 4. Thus, even though the newly extant
14 bankruptcy estate had no opportunity to respond to the FTC's
15 emergency motion, the Florida Court granted the FTC's emergency
16 motion. The Florida Court stated that the commencement of Debtor's
17 bankruptcy case did not stay the contempt proceedings against
18 Debtor or FTC's prosecution of the Enforcement Action and the
19 Florida Court vacated the September 20, 2007 order staying
20 proceedings against Debtor.

21 Also on September 21, 2007, this Court held a hearing on
22 Debtor's emergency motion for interim use of cash collateral and
23 Debtor's request for authority to maintain Debtor's pre-petition
24 bank accounts. In its motion for interim use of cash collateral,
25 Debtor requested court authority to use cash collateral pursuant to
26 a stipulation with its secured creditor PaymentOne. Debtor
27 asserted that PaymentOne was a secured creditor based on more than
28 \$6.4 million PaymentOne had loaned to Debtor between October 18,

1 2006 and the petition date (the "new value" provided by PaymentOne,
2 in bankruptcy parlance). The motion for authority to maintain
3 Debtor's pre-petition bank accounts was granted and the motion on
4 the interim use of cash collateral was continued to September 26,
5 2007.

6 Prior to the September 26, 2007 hearing, seven objections were
7 filed in opposition to Debtor's motion for interim use of cash
8 collateral. Some of the oppositions raised questions regarding
9 Debtor's viability and ability to operate successfully as a going
10 concern. Prior to and at the hearing, Debtor obtained the consent
11 of all parties to Debtor's use of cash collateral. In particular,
12 Debtor and Receiver agreed to set up the Blocked Account whereby
13 Debtor agreed to deposit \$1,762,762.56 of its commingled funds into
14 a blocked account and Debtor and Receiver agreed that the
15 establishment of the Blocked Account did not in any way affect the
16 merits of either parties' rights, claims or defenses with respect
17 to the funds in the Blocked Account. Based in part on the consent
18 of all parties, this Court granted Debtor interim use of cash
19 collateral through October 15, 2007 and set a further hearing on
20 the use of cash collateral for that day.

21 In papers relating to the September 26, 2007 hearing and at
22 that hearing, Debtor informed this Court that negotiations were
23 underway for a possible sale of PaymentOne to a third party.
24 Debtor also requested the expedited appointment of the unsecured
25 creditors' committee so that Debtor would have an entity with which
26 Debtor could talk on a confidential basis with, and obtain the
27 opinions regarding, possible reorganization scenarios, including
28 the possible sale of PaymentOne. On October 1, 2007, the United

1 States Trustee filed a notice that a committee of seven unsecured
2 creditors of Debtor had been appointed. Two days later the
3 Committee selected the law firm of Pachulski Stang Ziehl & Jones
4 LLP as its counsel, subject to approval of this Court. Within a
5 week, Debtor and the Committee executed a confidentiality
6 agreement; Debtor provided the Committee with various documents and
7 information requested by the Committee; and the Committee began the
8 process of analyzing that information.

9 On October 10, 2007, the Committee and Debtor participated in
10 a five hour face-to-face meeting. Discussions at that meeting
11 included Debtor's financial information -- including projections,
12 claims against Debtor, Debtor's plan for post-petition pre-payment
13 to Debtor's pre-petition customers, Debtor's relationship with the
14 LECs, the status of the Florida Action, as well as plan of
15 reorganization issues. At that meeting, the Committee agreed to
16 consent to Debtor's continued use of cash collateral through
17 November 2. Debtor committed to negotiate with the Committee a
18 term sheet for a plan of reorganization contemplating a
19 continuation of Debtor's business operations with the goal of
20 allowing Debtor to exit bankruptcy as quickly as possible, while
21 maximizing the value to unsecured creditors. The Committee stated
22 its intention to use the time between October 10 and November 2 to
23 conduct further due diligence on Debtor's assets, liabilities and
24 financial affairs in an effort to be in a better position to
25 evaluate an exit strategy for Debtor from bankruptcy.

26 On October 15, 2007, this Court held a second hearing on
27 Debtor's interim use of cash collateral. In support of Debtor's
28 continued use of such cash collateral, Debtor submitted budgets

1 showing Debtor's actual and projected post-petition finances.
2 Debtor submitted one budget assuming that Debtor could use the
3 funds in the Blocked Account as well as the assumption that the
4 Enforcement Action and related proceedings were stayed. Debtor
5 also submitted another budget without those assumptions. Regarding
6 the projected \$1 million in litigation expenses related to the
7 Florida Action, Debtor projected incurring \$333,333 for the weeks
8 ending November 2, 2007, December 7, 2007, and January 4, 2008.
9 Debtor asserted at that hearing, and continues to assert, that
10 Debtor needs the funds in the Blocked Account and that without the
11 ability to use the funds in the Blocked Account, Debtor will not
12 have sufficient cash flow as of mid-December 2007.

13 Debtor's continued use of cash collateral again drew seven
14 objections, but the primary concern of the objecting creditors was
15 with respect to the alleged secured nature of their respective
16 claims, and not on Debtor's ability to stay in business. In
17 addition, as noted above, Debtor's continued use of cash collateral
18 had the support of the Committee. On October 16, 2007, this Court
19 granted Debtor's continued interim use of cash collateral. A
20 hearing for final authority for Debtor to use cash collateral is
21 set for November 2, 2007.

22 Meanwhile, on October 1, 2007, Debtor requested additional
23 time -- until November 15, 2007 -- to file its schedules of assets
24 and liabilities ("Schedules") and statement of financial affairs
25 ("Statement"). In its application, Debtor noted the size and
26 complexity of Debtor's business operations, coupled with the
27 limited number of employees, who, in addition to their regular
28 duties, were capable of preparing the Statement and Schedules. On

1 October 23, 2007, this Court granted Debtor's request. Debtor's
2 Schedules and Statement are currently due on November 15, 2007.

3 On October 2, 2007, Debtor sought a temporary restraining
4 order from this Court enjoining the Enforcement Action and seeking
5 an order to show cause for the issuance of a preliminary
6 injunction. At that hearing, this Court denied Debtor's request
7 for a temporary restraining order of the Enforcement Action on the
8 basis that for the period from October 2, 2007 through October 17,
9 2007, Debtor had not demonstrated that the threatened injury to
10 Debtor outweighed the harms of a temporary restraining order
11 against the FTC.¹¹ However, the Court found that there was cause to
12 issue the OSC and the OSC was issued as to why a preliminary
13 injunction should not issue.

14 On October 11, 2007, Debtor filed in the Eleventh Circuit a
15 motion for an immediate interim stay of the Clarification Order in
16 as far as that order held that the Florida Action -- other than the
17 Enforcement Action -- was not automatically stayed. On October 17,
18 2007, the Eleventh Circuit temporarily granted Debtor's motion
19 pending further order of the court ("Stay Order").

20
21 II.

22 APPLICABLE LAW

23 In the non-bankruptcy context, [the Ninth Circuit
24 has] consistently required trial courts deciding
25 preliminary injunction motions to balance the moving
26 party's likelihood of success on the merits and the

27 ¹¹ While Debtor originally sought a temporary restraining order against Receiver's continued
28 enforcement of the Omnibus Order, the stipulation at the September 26 cash collateral hearing that
resulted in the temporary establishment of the Blocked Account resolved that need to both parties'
satisfaction.

relative hardship of the parties. The moving party must show:

(1) a strong likelihood of success on the merits, (2) the possibility of irreparable injury to plaintiff if preliminary relief is not granted, (3) a balance of hardships favoring the plaintiff, and (4) advancement of the public interest (in certain cases). Alternatively, a court may grant the injunction if the plaintiff demonstrates either a combination of probable success on the merits and the possibility of irreparable injury or that serious questions are raised and the balance of hardships tips sharply in his favor.

As we have said many times regarding the two alternative formulations of the preliminary injunction test: These two formulations represent two points on a sliding scale in which the required degree of irreparable harm increases as the probability of success decreases. They are not separate tests but rather outer reaches of a single continuum.

Save Our Sonoran, Inc. v. Flowers, 408 F.3d 1113, 1120 (9th Cir. 2005) (citations and internal quotation marks omitted).

Solidus Networks, Inc. v. Excel Innovations, Inc., (In re Excel Innovations, Inc.), --- F.3d ---, 2007 WL 2555941 at *5 (9th Cir. Sept. 7, 2007) (emphasis in original). The usual preliminary injunction standard applies to stays of proceedings under 11 U.S.C. § 105(a) ("Section 105"). Excel, 2007 WL 2555941 at *7. In Excel, a reorganization case, the Ninth Circuit stated that in granting or denying an injunction under Section 105, "a bankruptcy court must consider whether the debtor has a reasonable likelihood of a successful reorganization, the relative hardship of the parties, and any public interest concerns if relevant." Excel, 2007 WL 2555941 at *7.

1 III.

2 ANALYSIS

3 **A. Reasonable Likelihood of a Successful Reorganization**

4 In a reorganization context, a debtor seeking a stay against a
5 non-debtor must show a reasonable likelihood of a successful
6 reorganization. Excel, 2007 WL 2555941 at *7. This is not a high
7 burden, id. at *8, and a strong showing on the likelihood of a
8 successful reorganization lowers the burden to show irreparable
9 harm. Id. at *11.

10 The FTC argues that the Committee's unwillingness to consent
11 to a final cash collateral order speaks volumes about Debtor's
12 prospects -- or lack thereof -- of successfully reorganizing and
13 that it remains to be seen whether this will be a "real"
14 reorganization case. Citing general statistics, the FTC asserts it
15 is more likely that Debtor's case will fall into the 90% or more of
16 chapter 11 cases that are converted to liquidations or dismissed.
17 The FTC argues that overall the record at this point demonstrates
18 that Debtor's fate hangs precariously in the balance and a
19 liquidation scenario is more, or at least as likely as, a
20 successful reorganization and Debtor has not shown by a
21 preponderance of the evidence a likelihood of success on the
22 merits.¹²

23 Receiver asserts that Debtor has not shown a likelihood of
24 success on the merits on the basis that Debtor's support by the
25 Committee fails to address the numerous objections by creditors
26

27 ¹² A bankruptcy case may have an excellent result for creditors, even in a liquidation context.
28 For example, a successful sale of a debtor's business and subsequent liquidation of that debtor's
assets in a chapter 11 or a chapter 7 may result in a substantial distribution to creditors.

1 claiming a security interest in Debtor's assets to Debtor's
2 continued use of cash collateral. In addition, Debtor's strategy
3 over the near-term presupposes Debtor will be able to use the
4 Commingled Funds to fund Debtor's business operations, so Debtor
5 cannot show a likelihood of success on the merits.

6 The Court disagrees with the FTC and Receiver. The Court
7 finds that, at this juncture, Debtor has made a strong showing that
8 Debtor has a reasonable likelihood of a successful reorganization.
9 It is very early in Debtor's bankruptcy case -- Debtor's bankruptcy
10 case is only six weeks old. In that short period of time, Debtor
11 has obtained the confidence of its creditors that Debtor is a
12 viable business and has a reasonable likelihood of reorganizing
13 successfully. This is demonstrated in several ways. First,
14 following strenuous initial objections, Debtor's creditors
15 consented to Debtor's first interim use of cash collateral as soon
16 as Debtor demonstrated its viability to the objecting creditors.
17 Second, the LECs have for the most part continued to forward funds
18 to Debtor. Third, in an effort to retain customers, Debtor is
19 negotiating with its customers to provide a 50% pre-payment of the
20 transferred accounts receivables at the time of transfer rather
21 than having the customers wait 90 days, as those customers did pre-
22 petition. Debtor has obtained the Committee's support of that
23 plan. Fourth, the Committee is confident enough in Debtor's
24 prospects of reorganization that the Committee supported Debtor's
25 continued use of cash collateral for an additional three weeks to
26 enable the Committee and Debtor to work together on the terms of a
27 plan of reorganization.

1 In addition, Debtor and Debtor's 97%-owned subsidiary
2 PaymentOne are diligently exploring both a reorganization with
3 Debtor and a sale of PaymentOne's business to prospective
4 purchasers. The proceeds of such a sale could help Debtor fund a
5 plan of reorganization. Alternatively, Debtor is exploring the
6 possibility of a pot plan providing a pro-rata distribution to
7 unsecured creditors or a plan that would have Debtor continue its
8 operations and issue new stock in exchange for Debtor's unsecured
9 debt.

10 At this early stage of Debtor's bankruptcy case, Debtor's
11 reasonable likelihood of a successful reorganization is evident
12 from the support of Debtor's creditors and the Committee, Debtor's
13 clear pursuit of several viable avenues of possible reorganization,
14 Debtor's projections of positive cash flow for the next six months,
15 Debtor's retention of its customers and the continued success of
16 Debtor's business. Thus, Debtor has met its burden of showing a
17 reasonable likelihood of a successful reorganization.¹³

18 **B. The FTC's Enforcement Action**

19 The parties do not dispute for the purposes of the current
20 dispute that, under Bankruptcy Code section 362(b)(4), the
21 automatic stay does not stay the Enforcement Action.¹⁴ However, the

22
23 ¹³ Although the issue is not presented here, a court might appropriately enjoin an
24 enforcement action, like the FTC's, against a chapter 7 estate. The chapter 7 trustee might well
25 convince the court not to allow the enforcement action to proceed until the trustee and the court
26 knew what assets and liabilities there were in the estate. There would be no point, for example, in
27 allowing an enforcement action seeking a monetary judgment to proceed if the estate did not have
any money in it above the amount needed to pay administrative claims. There also might be no
purpose in enjoining a chapter 7 debtor from engaging in certain business practices, if that debtor
was out of business.

28 ¹⁴ While the Clarification Order in which the District Court held that Bankruptcy Code
(continued...)

1 FTC argues that this Court does not have authority to stay that
 2 litigation against Debtor under Section 105. This Court disagrees.
 3 Under In re First Alliance Mortg. Co., 264 B.R. 634 (C.D. Cal.
 4 2001) ("FAMCO") and the myriad of authorities cited therein, this
 5 Court has the legal authority to enjoin prosecution of governmental
 6 actions against a debtor that falls within the regulatory and
 7 police powers exception of Bankruptcy Code section 362(b)(4).
 8 FAMCO, 264 B.R. at 652 n.18.

9 This Court may enjoin the prosecution of the Enforcement
 10 Action under Section 105 if the Enforcement Action "threatens" the
 11 assets of the bankruptcy estate. FAMCO, 264 B.R. at 652. Under
 12 FAMCO, a Section 105 injunction could be appropriate against a
 13 regulatory action in two types of situations.

14 First, a governmental action that seeks actual
 15 physical control over the assets of the debtor's estate
 16 threatens the bankruptcy court's exclusive jurisdiction
 over the res of the debtor's estate and therefore can be
 enjoined. . . .

17 Second, a § 105 injunction of a regulatory or police
 18 powers action could be appropriate in other circumstances
 19 that severely threaten the integrity of the bankruptcy
 20 process. A few courts have enjoined regulatory or police
 21 powers actions on the grounds that the costs of defending
 the actions at issue, both in terms of money spent on
 22 lawyers' fees and time taken away from focusing on
 reorganization, were so high in comparison to the assets
 of the estate that allowing the actions to continue
 constituted a "threat" to the estate. E.g., NLRB v.
 23 Superior Forwarding, Inc., 762 F.2d 695, 698-99 (8th Cir.
 1985). Because the bankruptcy court has the obligation
 24 to protect and marshal the estate's assets, a severe
 enough threat to the assets of the estate constitutes a
 threat to the bankruptcy process.

25
 26
 27 ¹⁴(...continued)

28 section 362(b)(4) did not apply to the Florida Action is on appeal, in that appeal, Debtor has not
 challenged that Order insofar as the Clarification Order holds that the Enforcement Action is not
 automatically stayed.

1 Id. at 655. In balancing the hardships between the parties, "[a]
2 bankruptcy court must 'identify the harms which a preliminary
3 injunction might cause to defendants and ... weigh these against
4 plaintiff's threatened injury.' Caribbean Marine Servs. Co. v.
5 Baldrige, 844 F.2d 668, 676 (9th Cir. 1988) (citation omitted)."
6 Excel, 2007 WL 2555941 at *9.

7 **1. Harms to FTC**

8 The FTC articulates that the FTC would be harmed by the
9 granting of a preliminary injunction because the FTC only seeks
10 what the FTC terms as "equitable" relief in the Enforcement Action
11 and this Court cannot grant all of the relief requested by the
12 FTC.¹⁵ But there is no doubt that the FTC seeks to collect monies
13 from Debtor. Specifically, the FTC seeks monetary injunctive
14 relief in the form of disgorgement of monies received from
15 consumers and restitution to the consumers. In addition, the FTC
16 seeks a permanent injunction halting Debtor's allegedly unlawful
17 practices, rescission of contracts and a claims procedure to
18 provide restitution to the consumers who allegedly paid for
19 unauthorized charges on their phone bills.

20 The FTC also asserts that being enjoined from proceeding in
21 its chosen forum -- the Florida Court -- would harm the FTC in
22 other critical ways. The FTC quotes extensively from FAMCO which
23 states in this regard:

24 [T]he hardship to the governmental units of not being
25 allowed to proceed with their actions in their chosen
26 forums includes harms different in character from the

27 ¹⁵ While this Court does not necessarily agree with the FTC that this Court could not grant
28 all equitable relief requested by the FTC in the Enforcement Action, due to the limited nature of the
preliminary injunction being granted at this time, there is no reason for this Court to address the
FTC's assertion.

1 harms normally considered on motions for injunctions
2 under § 105. Being able to have a claim determined by
3 the bankruptcy court is qualitatively different from
4 proceeding with a lawsuit in home forums. As Congress
5 recognized when it created the regulatory and police
6 powers exception, the goals of public policy, punishment,
7 and deterrence may sometimes conflict with the goals of
8 maximizing an individual estate's assets and efficiently
9 processing claims. It is the former goals, which are
10 difficult if not impossible to measure in dollars and
11 cents, that are impaired when a governmental unit loses
12 the ability to enforce its laws in its own forum.

13 Considering deterrence in particular, the harm to
14 the governmental units must be measured with a broader
15 perspective in mind than these parties alone. The
16 bankruptcy court and First Alliance are undoubtedly
17 correct that there will be more money to distribute to
18 borrowers in this case if the separate actions are not
19 allowed to proceed. However, the governmental units are
20 entitled to make the choice that, over time, similarly
21 situated borrowers and consumers benefit more when
22 companies do not violate the law in part because they
23 know that bankruptcy will not provide a way out when
24 their wrongs are discovered. In any given case,
25 reasonable minds could disagree about the marginal costs
26 and the marginal benefits of different approaches and
27 which will maximize the wealth and happiness of the
28 greatest number of people. The point is that it is the
governmental units charged with enforcing consumer
protection laws, governmental units that are responsive
to the political will of the people, that should be the
ones to make the choice, not the bankruptcy court.

18 FAMCO, 264 B.R. at 659.

19 The FTC asserts that the FTC's need for permanent injunctive
20 relief is particularly acute here because the FTC needs permanent
21 injunctive relief from the Florida Court barring Debtor's allegedly
22 unlawful business practices. The FTC asserts that the FTC's
23 pursuit of phone billing aggregators such as Debtor is a vital
24 enforcement strategy that the FTC has pursued to curb the allegedly
25 insidious and unlawful practice of placing unauthorized charges on
26 consumers' phone bills. During the past nine years, the FTC has
27 filed numerous actions against telephone billing aggregators and
28 has obtained injunctive and monetary equitable relief. The FTC

1 notes that this is not the first time that the FTC has sued Debtor
2 (the previous suit was settled) and some of Debtor's current
3 customers were recently prosecuted by state attorneys general for
4 placing unauthorized charges on consumers' phone bills and other
5 alleged deceptive trade practices.

6 **2. Harms to Debtor**

7 Debtor has filed a chapter 11 bankruptcy petition. "The
8 purpose of title 11 protection is to allow an entity to
9 'restructure ... finances' and enter a plan of reorganization so
10 that it is able to 'continue to operate, provide its employees with
11 jobs, pay its creditors, and produce a fair return for its
12 stockholders.'" CFTC v. NRG Energy, Inc., 457 F.3d 776, 779 (8th
13 Cir. 2006) (internal citation omitted). Said a different way,
14 "[t]he purpose of Chapter 11 reorganization is to assist
15 financially distressed business enterprises by providing them with
16 breathing space in which to return to a viable state." In re
17 Little Creek Dev. Co., 779 F.2d 1068, 1073 (5th Cir. 1986) (quoting
18 In re Winshall Settlor's Trust, 785 F.2d 1136, 1137 (6th Cir.
19 1985)). Here "Debtor 'is a real company with real debt, real
20 creditors and a compelling need to reorganize in order to meet
21 these obligations' and is therefore, exactly the type of debtor for
22 which chapter 11 was enacted." In re Dow Corning Corp., 244 B.R.
23 673, 677 (Bankr. E.D. Mich. 1999), aff'd, 255 B.R. 445 (E.D. Mich.
24 2000) (internal citation omitted). In determining irreparable
25 injury to Debtor, this Court must consider the impact of permitting
26 the Enforcement Action to proceed against Debtor at this point in
27 Debtor's bankruptcy case.

1 Debtor raises two main harms that would cause irreparable
2 injury should this Court not preliminarily enjoin the Enforcement
3 Action. First, Debtor anticipates having to spend over \$900,000 in
4 fees and costs over the next six months in the Enforcement Action.
5 Debtor estimates it will incur \$821,600 in litigation fees related
6 to depositions, discovery motions, dispositive motions, other
7 motions, pre-trial submissions and trial. In addition, Debtor
8 estimates that there will be an estimated \$10,000 in fees for local
9 counsel and an estimated \$50,000 to \$70,000 in costs. Debtor's
10 budgets show that Debtor will not be able to operate on an
11 administratively solvent¹⁶ basis if Debtor is forced to incur these
12 substantial fees over the next six months.

13 The FTC argues that Debtor overestimates its costs to defend
14 against the Enforcement Action. The FTC asserts that the
15 declaration of Neal Goldfarb submitted by Debtor in support of its
16 request lacks sufficient detail to support Debtor's proposed
17 estimate. Moreover, the FTC argues that the estimate overstates
18 the amount of estimated trial time and fails to consider that some
19 of the issues in the Enforcement Action will be narrowed, if not
20 eliminated, by summary judgment since the FTC's position is that
21 the uncontested facts establish Debtor's liability.

22 The FTC further contends that the relevant comparison under
23 FAMCO is not between Debtor's costs of defending itself against the
24 _____

25 ¹⁶ In a chapter 11 bankruptcy case, all post-petition obligations have administrative priority
26 status. This means that those claims are paid prior to most other claims in a bankruptcy estate,
27 namely other priority claims and pre-petition unsecured claims. In addition, those claims must be
28 paid in full on the effective date of a confirmed plan of reorganization. The effective date is usually
30 days after an order confirming a plan of reorganization is entered, but can be in as few as eleven
days. To stay administratively solvent, a debtor would insure that debtor retains sufficient cash
reserves on hand to pay all administrative claims in full on the effective date of a plan.

1 FTC in the Florida Court or not defending itself at all, but rather
 2 between Debtor defending itself in the Florida Court and defending
 3 itself in this Court. According to the FTC, unless the Enforcement
 4 Action is concluded as to Debtor, the same facts will have to be
 5 litigated in this Court to establish a bankruptcy claim against
 6 Debtor.¹⁷ Moreover, under the recently enacted changes to the
 7 Bankruptcy Code, the FTC can pursue a non-dischargeability action
 8 against Debtor for the FTC's monetary claim. Finally, the FTC
 9 alleges that it would pursue the non-monetary aspects of the
 10 Enforcement Action after confirmation of Debtor's plan. NRG
 11 Energy, 457 F.3d at 780-81 (holding that a bankruptcy court has no
 12 authority to enjoin a government agency from bringing a post-
 13 confirmation enforcement action against a reorganized debtor for
 14 injunctive relief against future law violations).¹⁸

15 The FTC does not address the second harm raised by Debtor: the
 16 impact of the continuation of the Enforcement Action on Debtor's
 17 reorganization efforts. Debtor has relatively few employees and
 18 Debtor's president, Mr. Dawson -- one of the founders of Debtor --
 19 is and will continue to be very closely involved in Debtor's
 20 defense in the Enforcement Action. Mr. Dawson is also the main
 21 contact for all of Debtor's reorganization efforts in addition to

22
 23 ¹⁷ This argument is incorrect, or at least premature, because the Court is only enjoining the
 24 Enforcement Action for a few months and has not determined whether the Enforcement Action will
 25 be adjudicated in the Florida Court or in this Court, if it ultimately needs to be adjudicated at all. It
 26 might well settle in the bankruptcy context in connection with a plan of reorganization or otherwise.
 27 In this connection, the desire of the post-petition Debtor and the FTC to resolve their disputes may
 28 be significantly greater than the situation before Debtor filed for bankruptcy.

Furthermore, even if the matter were tried in the bankruptcy court, this Court would
 determine when the trial should take place.

¹⁸ However, as noted, Debtor and the FTC may well settle those disputes in the context of
 Debtor's plan of reorganization or otherwise.

1 his duties overseeing normal operational issues. The bankruptcy
2 filing unsettled Debtor's customers and Debtor is working on a
3 proposed pre-payment plan whereby Debtor would pay 50% of the
4 receivables represented by post-petition billing submissions.
5 Because this is a new program, the program will be time-consuming
6 to implement and monitor. In addition, Mr. Dawson needs to be
7 available to work with Debtor's reorganization counsel, the various
8 secured and unsecured creditors, the Committee and the United
9 States Trustee.

10 Further, the Committee supports Debtor's use of cash
11 collateral through November 2, 2007. In exchange, Debtor has
12 committed to negotiate with the Committee a term sheet for a plan
13 of reorganization contemplating a continuation of Debtor's business
14 operations with the goal of allowing Debtor to exit bankruptcy as
15 quickly as possible. Debtor is also monitoring the possible sale
16 of PaymentOne to a third party.

17 Finally, upon Debtor filing its chapter 11 bankruptcy
18 petition, Debtor became a "debtor-in-possession." As a debtor-in-
19 possession, Debtor acts as a fiduciary to the bankruptcy estate and
20 owes a duty of care and loyalty to the bankruptcy estate's
21 creditors. In re McConville, 110 F.3d 47, 50 (9th Cir. 1997).
22 Thus, Debtor thus is a new entity with different and additional
23 responsibilities, concerns and pressures than it had when Debtor
24 operated solely as Integretel. Debtor, the Committee and Debtor's
25 other creditors need time to evaluate the merits and strengths of
26 the FTC's positions and decide whether the bankruptcy estate should
27 try to settle the Enforcement Action with the FTC. Giving Debtor
28 and Debtor's creditors a few months to do that is critical at this

1 juncture -- particularly in the context of negotiating a plan of
2 reorganization.

3 **3. Balancing of the Harms and the Public Interest**

4 Based on the unique facts of this case and in consideration
5 of the relative hardship of the parties and the public interest
6 concerns, the Court finds that continued prosecution of the
7 Enforcement Action severely threatens the integrity of the
8 bankruptcy process and Debtor's prospects for reorganization and a
9 preliminary injunction of the Enforcement Action against Debtor
10 through March 14, 2008 is warranted. On March 7, 2008 at
11 1:00 p.m., the Court will hold a further hearing on whether the
12 preliminary injunction of the Enforcement Action should be
13 continued beyond March 14, 2008. Either the FTC or Debtor may
14 request that the preliminary injunction be lifted before March 7,
15 2008 for good cause based on facts that are not currently before
16 this Court.

17 The FTC is concerned that this Court's granting of a
18 preliminary injunction against the Enforcement Action will set a
19 precedent that a defendant can escape prosecution for committing
20 deceptive and unfair trade practices by simply filing for
21 bankruptcy. The Court is keenly aware of the FTC's concern and
22 that is not what this Court intends. Rather, it is the unusual
23 convergence -- almost a perfect storm -- of the trial schedule in
24 the Enforcement Action and the critical first few months of a
25 viable chapter 11 bankruptcy case that warrant a limited
26 preliminary injunction at this time.

27 First, the next several months are a critical time for Debtor
28 in its effort to reorganize, and the immediate continuation of the

1 Enforcement Action seriously threatens Debtor's ability to
2 reorganize. Debtor has only 37 employees to service its 58 pre-
3 petition customers and manage Debtor's relations with over 1400
4 LECs. Moreover, Debtor's president, Mr. Dawson, is and will
5 continue to be closely involved in Debtor's defense in the
6 Enforcement Action. If the Enforcement Action is not temporarily
7 stayed, Mr. Dawson would be required to divert his time and
8 attention from Debtor's reorganization between November 6 and
9 December 4, 2007 to assist Debtor's counsel in the Enforcement
10 Action in preparing an opposition to a motion for summary judgment
11 that the FTC has stated it will file against Debtor. There may
12 also be eleven or more additional depositions in which Debtor will
13 need to participate if the Florida Court grants the pending motions
14 requesting additional discovery. In addition, Mr. Dawson will be
15 required to fly to Florida during February 2008 to prepare for and
16 participate in the trial in the Enforcement Action scheduled to
17 commence on February 25, 2008.¹⁹ The diversion of Debtor's
18 management -- and Mr. Dawson in particular -- in defending the
19 Enforcement Action during the next few months seriously threatens
20 Debtor's reorganization.

21 Mr. Dawson is the main contact for all of Debtor's
22 reorganization efforts in addition to his duties overseeing normal
23 operational issues. Debtor's reorganization efforts -- especially
24 at this early stage of Debtor's bankruptcy case -- are time-
25 consuming. First, under the Bankruptcy Code, Debtor is required to
26

27 ¹⁹ The trial situation could possibly change if FTC does file a summary judgment motion and
28 it is granted in part or in full. However, Debtor will still need to prepare for trial because Debtor
cannot know in advance what the result will be of any as yet to be filed FTC motions.

1 obtain court approval for the use of its cash collateral post-
2 petition. This is a marked difference from how Debtor operated
3 pre-petition. Pre-petition Debtor could use any cash that came
4 into Debtor's accounts subject only to claims of various creditors.
5 Post-petition, however, Debtor must obtain the consent of all
6 creditors who have an interest in that cash collateral or court
7 approval for the use of that cash collateral. In this instance,
8 the Court has approved Debtor's use of cash collateral on an
9 interim basis at three-week intervals. Debtor has scheduled a
10 final hearing for use of cash collateral for November 2, which
11 depending on the status of its negotiations with its creditors,
12 Debtor may or may not change to another interim request for use of
13 cash collateral.

14 It is not unusual in a chapter 11 bankruptcy case for a debtor
15 to seek multiple interim requests for use of cash collateral while
16 a debtor negotiates with secured and unsecured creditors for final
17 consent to a debtor's use of cash collateral. In the early stages
18 of a bankruptcy case, creditors are getting up to speed regarding a
19 debtor's business operations and the relative likelihood of
20 recoveries for creditors pursuant to various reorganization
21 proposals. During this time, creditors, debtors and the bankruptcy
22 court strike a balance among the parties' interests and grant
23 limited permission for a debtor to use post-petition cash
24 collateral until the parties are comfortable with a debtor's plans
25 to operate and can resolve a debtor's use of cash collateral on a
26 final basis. The early, limited permission to use cash collateral
27 is in part why a chapter 11 bankruptcy case is so time-intensive
28 for a debtor, and indeed all parties in the early stages.

1 Second, the bankruptcy filing unsettled Debtor's customers and
2 Debtor is actively working on a proposed pre-payment plan whereby
3 Debtor would pay 50% of the receivables represented by post-
4 petition billing submissions. This is a marked change from
5 Debtor's pre-petition operations where Debtor paid its customers
6 approximately 90 days after the billing transactions were submitted
7 to Debtor. Because the pre-payment program is new, Mr. Dawson and
8 Debtor's other employees will have to spend a great deal of time
9 implementing and monitoring the new program.

10 Further, the Committee was appointed on October 1, 2007 and on
11 October 10, 2007, the Committee had a five hour face-to-face
12 meeting with Debtor. At that meeting the Committee supported
13 Debtor's use of cash collateral through November 2, 2007 and in
14 exchange Debtor has committed to negotiate with the Committee a
15 term sheet for a plan of reorganization contemplating a
16 continuation of Debtor's business operations with the goal of
17 allowing Debtor to exit bankruptcy as quickly as possible. Debtor
18 is also monitoring the possible sale of PaymentOne to a third
19 party. Mr. Dawson is a, and probably the, critical participant in
20 those discussions and negotiations.

21 Finally, Debtor has complex business operations and over 1,200
22 creditors on its creditor matrix. Due to the size and complexity
23 of Debtor's business operations, Debtor requires -- and has been
24 granted -- additional time to complete its Schedules and Statement
25 of Financial Affairs. Those documents are currently due on
26 November 15, 2007. The Schedules consist of seven separate
27 schedules that require Debtor to: (a) list in detail all real and
28 personal property, the value of each piece or category of property,

1 and the security interest held against that property; (b) provide
2 separate lists of Debtor's creditors -- secured creditors, priority
3 unsecured creditors and unsecured creditors that includes an
4 address for each creditor, information regarding when the claim was
5 incurred and consideration for the claim, whether the claim is
6 contingent, unliquidated or disputed, and the amount of the claim;
7 (c) provide a detailed list of all executory contracts and
8 unexpired leases; and (d) provide a list of all entities that are
9 co-debtors with Debtor. The Statement requires Debtor to answer
10 twenty-five questions in detail regarding Debtor's financial
11 affairs. The questions require Debtor to detail, inter alia, all
12 payments or transfers Debtor made in the 90 days immediately
13 preceding the commencement of the case that aggregate more than
14 \$5,475 to any creditor, and all payments or transfers Debtor made
15 within one year immediately preceding the commencement of the case
16 to any creditor that is an insider (all of the majority-owned
17 subsidiaries of Debtor are considered to be insiders).

18 Based on these projected activities, Debtor's management --
19 and Mr. Dawson in particular -- will spend the next few months
20 dealing with Debtor's customers and creditors, completing Debtor's
21 Schedules and Statement, negotiating with the Committee over the
22 terms for a plan of reorganization and, if successful, most of
23 November and early December will be spent negotiating a draft plan
24 of reorganization and overseeing the preparation of a proposed
25 disclosure statement. Both of these documents will require
26 substantial amounts of time on the part of Mr. Dawson and Debtor's
27 other personnel. The plan of reorganization is Debtor's contract
28 with its creditors as to how Debtor intends to restructure itself

1 using the Bankruptcy Code. In addition, the proposed disclosure
2 statement is similar to a prospectus and will require, inter alia,
3 a description of Debtor's background, the events that caused Debtor
4 to file its bankruptcy case, what has changed such that Debtor will
5 be able to complete its proposed plan of reorganization, a
6 description of the proposed plan, and financial projections in
7 support of the plan if Debtor proposes to present a plan that
8 permits Debtor to operate as a going concern. Debtor must submit
9 its proposed disclosure statement to this Court for approval. 11
10 U.S.C. § 1125(b). Such activities will consume a huge portion of
11 the available time of Debtor's management over the next few months.

12 However, should Debtor be required to proceed to trial in the
13 Enforcement Action at the end of February 2008, Mr. Dawson and
14 other of Debtor's personnel will be required to travel to Florida
15 and spend many days -- if not weeks in the case of Mr. Dawson --
16 preparing for and participating in the trial in the Enforcement
17 Action. This activity will take place at a critical juncture of
18 Debtor's bankruptcy case where Debtor should instead be seeking
19 confirmation of a plan of reorganization. Debtor is committed to
20 proposing a plan of reorganization on an expeditious basis. Under
21 the notice requirements of the Bankruptcy Code and Rules, it is
22 highly likely that Debtor will seek approval of a disclosure
23 statement during January 2008, and could set a confirmation hearing
24 on a proposed plan of reorganization during February or March 2008.

25 Confirmation of a chapter 11 plan requires an enormous amount
26 of work for both a debtor and its counsel. In addition to
27 resolving and addressing any objections by any parties to approval
28 of a disclosure statement and confirmation of a plan, this Court

1 has an independent duty to ensure that a disclosure statement
2 contains adequate information, In re Main Street AC, Inc., 234 B.R.
3 771, 774 (Bankr. N.D. Cal. 1999), and an affirmative duty to ensure
4 that a plan satisfies all sixteen requirements of Bankruptcy Code
5 section 1129 for confirmation. In re Ambanc La Mesa Ltd. P'ship.,
6 115 F.3d 650, 653 (9th Cir. 1997). Just one of the requirements is
7 that this Court must determine that confirmation of Debtor's plan
8 will not likely be followed by the liquidation or further financial
9 reorganization. 11 U.S.C. § 1129(a)(11). Mr. Dawson will almost
10 certainly be required to testify before this Court as to Debtor's
11 plan and the financial projections on which it is based, as well as
12 other evidence this Court requires to confirm any proposed plan
13 submitted for confirmation by Debtor.

14 In addition to the impact of the Enforcement Action on
15 Debtor's president and other personnel, it would be highly
16 injurious to Debtor and Debtor's prospects for reorganization if
17 Debtor had to spend the bulk of the estimated \$1 million in legal
18 fees and costs associated with the Enforcement Action during this
19 same critical period. Such an outlay of funds at a critical time
20 of confirmation would seriously impair, if not strike a death
21 knell, to Debtor's prospects for a reorganization. Debtor is
22 required under the Bankruptcy Code to pay all administrative claims
23 as of the effective date of a confirmed plan. 11 U.S.C.
24 § 1129(a)(9)(A). Debtor may well not have sufficient funds to both
25 pay the litigation costs of defending the Enforcement Action and
26 pay administrative claims on the effective date of a confirmed
27 plan.
28

1 The FTC likely holds only a pre-petition unsecured claim
2 against Debtor in the Enforcement Action. Any monetary claims FTC
3 asserts against Debtor arise only from Debtor's alleged pre-
4 petition placing of unauthorized collect call charges onto
5 consumers' telephone bills. There is no showing that at this point
6 there is any reason for Debtor to spend \$1 million litigating an
7 unsecured claim in the next five months. First, at this juncture
8 it is unclear what unsecured creditors will receive in Debtor's
9 reorganization and it is unknown if spending \$1 million to defend
10 against the FTC's claims makes sense, especially in this case where
11 secured and other unsecured creditors desperately need for all
12 resources to be devoted to Debtor's reorganization efforts.
13 Second, over the next five months Debtor may negotiate a resolution
14 of the FTC's claims without the need for litigation. This Court is
15 not determining at this juncture where the FTC's claims will be
16 liquidated. Rather, this Court is merely delaying briefly the
17 Enforcement Action against Debtor only.²⁰ It is this Court's
18 experience that in chapter 11 cases such as Debtor's, a debtor
19 typically negotiates with the various creditors to reach a
20 consensus as to the structure of a plan of reorganization. It is
21 generally less expensive and easier if a debtor can negotiate a
22 plan of reorganization than if a debtor has to confirm a plan of
23 reorganization over the objections of numerous creditors. At the
24 early stages of Debtor's case and under the facts of this case, a
25 preliminary injunction of limited duration is warranted.

26
27 ²⁰This Court's decision stays the Enforcement Action against Debtor for a few months. This
28 decision does not determine whether (1) the FTC may recommence the Enforcement Action in the
Florida Court after those few months, or (2) whether the FTC should be required to pursue Debtor by
filing a claim with, and litigating that claim in, the bankruptcy court.

1 By limiting the duration of the preliminary injunction and
2 requiring Debtor to provide further updated evidence in mid-
3 February 2008 to support the continued injunction of the
4 Enforcement Action, this Court eliminates or at least reduces
5 substantially the alleged harms of the FTC. The FTC cites three
6 harms from a possible injunction of the Enforcement Action: (1) the
7 inability of the FTC to obtain the non-monetary equitable relief it
8 seeks against Debtor; (2) the inability of the FTC to pursue the
9 claims in the Enforcement Action against Debtor in the Florida
10 Court; and (3) the public interest in permitting the FTC to pursue
11 a vital enforcement strategy to curb the unlawful practice of
12 placing unauthorized charges on consumers' phone bills. However,
13 this Court has not eliminated, and is not eliminating, the
14 possibility that at a later date this Court would permit the FTC to
15 prosecute the Enforcement Action in the Florida Court, including
16 the ability of the FTC to obtain the non-monetary equitable relief
17 it seeks against Debtor. The FTC itself notes that it will seek
18 such relief against Debtor post-confirmation. This Court is merely
19 delaying for a few months the FTC's prosecution of the Enforcement
20 Action against Debtor. No decision has yet been made as to where
21 the FTC's claims will be litigated if indeed those claims need to
22 be litigated at all.

23 Granting a preliminary injunction of limited duration also
24 renders premature the FTC's argument that this Court must consider
25 Debtor's costs of Debtor defending itself in the Florida Court and
26 defending itself in this Court rather than Debtor's costs of
27 defending itself against the FTC in the Florida Court or not
28 defending itself at all. First, Debtor will not likely be

1 prosecuting an objection to the FTC's claim in the next few months.
2 Indeed, March 14, 2008 is the claims bar date for governmental
3 units in Debtor's bankruptcy case. Thus, for this limited duration
4 preliminary injunction, Debtor almost certainly will not incur any
5 costs defending itself in this Court against the FTC's claims.²¹

6 **C. Contempt Proceedings and Turnover Action**

7 **1. Debtor's Ability to Sue the Receiver**

8 Receiver argues that this Court lacks subject matter
9 jurisdiction over this adversary proceeding as to Receiver because
10 Debtor has not obtained permission from the Florida Court to bring
11 this action -- or any action -- against Receiver. Receiver asserts
12 that for over 100 years, legal authority holds that a litigant must
13 obtain permission from the court appointing a receiver before
14 bringing an action against that receiver. Carter v. Rodgers, 220
15 F.3d 1249, 1252 (11th Cir. 2000) (holding that under Barton v.
16 Barbour, 104 U.S. 126 (1881), a debtor must obtain leave from the
17 bankruptcy court before the debtor can initiate an action in
18 district court against a bankruptcy-court appointed trustee for
19 breach of fiduciary duties); In re Crown Vantage, Inc., 421 F.3d
20 963, 970 (9th Cir. 2005) (a bankruptcy-court appointed trustee of a
21 liquidating trust cannot be sued in a foreign jurisdiction for
22 violating a settlement agreement without the permission of the
23 court appointing the trustee).

24 Debtor asserts that the Barton doctrine applies only if Debtor
25 were suing Receiver for dereliction of duties, which Debtor is not
26 doing in this adversary proceeding. Moreover, Debtor argues that
27 Crown Vantage stands for the proposition that Debtor does not need
28

²¹ See footnote 17, supra.

1 leave from the Florida Court to sue Receiver in this instance
2 because this Court has exclusive in rem jurisdiction to determine
3 the property of Debtor's bankruptcy estate and the injunctive
4 relief requested by Debtor is a stay specifically designed to
5 protect the assets of the bankruptcy estate, so the Barton doctrine
6 is not invoked.

7 This Court agrees with Debtor that once Debtor filed its
8 bankruptcy petition on September 16, 2007, this Court obtained
9 exclusive in rem jurisdiction over the property in Debtor's
10 bankruptcy estate, and particularly over any legal and equitable
11 interest Debtor held in the Commingled Funds as of the commencement
12 of the case. While none of the parties or this Court have found
13 any cases directly on point, the Court finds Gilchrist v. General
14 Elec. Capital Corp., 262 F.3d 295 (4th Cir. 2001), particularly
15 instructive.

16 In Gilchrist, Spartan International, Incorporated and its
17 subsidiaries (collectively, "Spartan") closed their doors for
18 business. Spartan's major creditor ("GE") commenced a state law
19 debt-collection action invoking the diversity jurisdiction of the
20 district court of South Carolina ("South Carolina Court"). To
21 facilitate the foreclosure of the creditor's lien, the South
22 Carolina Court appointed a federal receiver for all of Spartan's
23 assets ("Receiver Order"). The Receiver Order enjoined all persons
24 from commencing or prosecuting any action, suit or proceeding that
25 affected the receivership estate or Spartan. Gilchrist, 262 F.3d
26 at 297-98.

27 One week later and with actual notice of the Receiver Order,
28 50 creditors ("Georgia Creditors") filed an involuntary bankruptcy

1 petition in the bankruptcy court in the Southern District of
2 Georgia ("Georgia Court") and a request for the appointment of an
3 interim bankruptcy trustee. GE objected to the appointment of an
4 interim bankruptcy trustee and filed a motion to dismiss the
5 involuntary bankruptcy petition or transfer venue to the district
6 of South Carolina. The receiver filed a similar motion. Following
7 a hearing, the Georgia Court overruled the objections, denied the
8 motions and appointed an interim bankruptcy trustee. Gilchrist,
9 262 F.3d at 298.

10 While that hearing was in progress, the receiver obtained a
11 temporary restraining order from the South Carolina Court enjoining
12 38 of the Georgia Creditors from undertaking any action in
13 furtherance of the involuntary bankruptcy petition. Four days
14 later the South Carolina Court found the Georgia Creditors in
15 contempt of the Receiver Order and allowed the Georgia Creditors to
16 purge their contempt by withdrawing the bankruptcy petition. The
17 interim bankruptcy trustee argued that the automatic stay precluded
18 the South Carolina Court's actions, but the South Carolina Court
19 refused to recognize the automatic stay of its proceedings. The
20 South Carolina Court asserted that it had jurisdiction to determine
21 the scope of the automatic stay, and it had the authority to issue
22 an injunction to prevent the collateral attack of that court's
23 Receiver Order appointing the receiver. In an effort to purge
24 their contempt, the Georgia Creditors subsequently filed a petition
25 in the Georgia Court to withdraw the involuntary petition, which
26 the Georgia Court denied. The Georgia Court stayed further
27 proceedings pending a review of the South Carolina Court's orders
28 by the Fourth Circuit. Gilchrist, 262 F.3d at 298-99.